

Message Text

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ACTION NEA-09

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-03 H-02 INR-07 L-02

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 TRSE-00 XMB-02 OPIC-03

CIEP-01 LAB-04 SIL-01 OMB-01 STR-04 AGR-05 SAM-01

/091 W

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R 260545Z APR 75

FM AMEMBASSY KATHMANDU

TO SECSTATE WASHDC 1517

INFO AMEMBASSY NEW DELHI

LIMITED OFFICIAL USE SECTION 1 OF 2 KATHMANDU 1930

E.O. 11652: N/A

TAGS: ECON, NP

SUBJECT: GON DEFENDS NEW ECONOMIC MEASURES

1. SUMMARY: DURING LAST WEEK, NEW RIJAL GOVERNMENT HAS TAKEN ACTION TO INCREASE INTEREST RATES AND TO RAISE PRICES TO CONSUMERS OF RICE AND SUGAR. MEASURES HAVE BEEN CRITICIZED BY PRESS AND PUBLIC WHO FEAR FURTHER PRICE INCREASES. CRITICISM HAS FORCED GOVERNMENT TO COME OUT WITH STATEMENTS IN ITS OWN DEFENSE. UNLESS ACTION HAS DESIRED RESULT OF INCREASING PRODUCTIVE INVESTMENT AND DOMESTIC AVAILABILITY OF FOOD SUPPLIES -- AND THERE IS GOOD CHANCE THAT IT WILL NOT -- EFFECT MAY BE TO INCREASE DOMESTIC DISSATISFACTION, WEAKEN POSITION OF PRIME MINISTER AND ENHANCE POSSIBILITY OF NEW MINISTERIAL CHANGES LATER IN YEAR. END SUMMARY.

2. SEVERAL ECONOMIC MEASURES IMPLEMENTED BY THE GOVERNMENT WITHIN THE LAST WEEK HAVE BEEN DENOUNCED
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BY CONSUMERS AND THE PRIVATE SECTOR, CAUSING GOVERN-

MENT SPOKESMEN TO ISSUE STATEMENTS DEFENDING THE
NEW POLICIES:

A) INCREASE IN INTEREST RATES -- NEPAL'S RASTRA
BANK ANNOUNCED A SHARP INCREASE IN INTEREST RATES,
BOTH FOR LOANS AND FOR SAVINGS ACCOUNTS. INTEREST
RATES ON SMALL LOANS FOR AGRICULTURAL, INDUSTRIAL
AND EXPORT PURPOSES HAVE BEEN INCREASED FROM 8 PERCENT TO
15 PERCENT. INTEREST RATES ON LOANS BY THE AGRICULTURAL
DEVELOPMENT BANK TO THE PRIVATE SECTOR HAVE BEEN
RAISED FROM THE FORMER RANGE OF 5 AND ONE-HALF TO 9
AND ONE-HALF PERCENT TO NEW LEVEL OF FROM 10 TO 15
PERCENT. SIMILARLY, INTEREST RATES FOR LOANS BY
NEPAL INDUSTRIAL DEVELOPMENT CORPORATION HAVE BEEN
RAISED FROM FORMER LEVEL OF 3 PERCENT TO 9 PERCENT TO LEVEL OF
10 TO 16 PERCENT. (THE 10 PERCENT RATE IS A CONCESSIONAL
RATE FOR COTTAGE INDUSTRIES.) ON THE DEPOSIT SIDE, THE
NEW INTEREST RATE FOR SAVINGS ACCOUNTS IS SET AT 8 PERCENT
WITH RATES FOR FIXED DEPOSITS RANGING FROM 4 PERCENT
FOR THREE MONTHS TO 15 PERCENT FOR ONE YEAR AND 16 PERCENT FOR
TWO YEARS. IN EXPLAINING NEW POLICY, GOVERNOR SHARMA

OF RASTRA BANK SAID THAT INCREASE WAS NECESSARY TO
ATTRACT NEW DEPOSITS AS LAST YEAR BANK LOANS
INCREASED BY 56 PERCENT, WHILE SAVINGS ROSE BY ONLY 19 PERCENT.
FOR FIRST SIX MONTHS OF CURRENT FISCAL YEAR, BANK
LOANS HAD AGAIN INCREASED BY 56 PERCENT WHILE SAVINGS WERE
UP BY ONLY 6 PERCENT. SHARMA ALSO ARGUED THAT HIGHER
INTEREST RATES WOULD CONTRIBUTE TO ACCELERATION OF ECONOMIC
DEVELOPMENT AS INVESTMENTS WOULD NOW ONLY BE MADE IN
PRODUCTIVE SECTORS AND THERE WOULD BE INCENTIVE TO
UTILIZE LOANS AS EFFICIENTLY AND QUICKLY AS
POSSIBLE.

B) PRICE INCREASES FOR RICE AND SUGAR -- OF
MORE IMMEDIATE IMPORTANCE TO MOST NEPALESE WAS THE
GOVERNMENT'S DECISION TO INCREASE THE PRICES OF BOTH
PARBOILED RICE AND SUGAR. SINCE INSTITUTIONALIZING
RICE EXPORT TRADE, THE GOVERNMENT'S RICE CORPORATION
HAS PROVIDED COARSE PARBOILED RICE, A VARIETY CONSUMED
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PRIMARILY BY THE LOWER CLASSES, AND WHICH THE GOVERNMENT
OBTAINS THROUGH A LEVY ON EXPORTS, AT PRICES FIXED
BELOW EXPORT PRICES. FOR POLITICAL REASONS, PARBOILED
RICE WAS SOLD AT A CHEAPER PRICE IN KATHMANDU VALLEY
THAN IN THE TERAJ WHERE IT IS PRODUCED. IN RECENT
MONTHS, INCREASING NUMBERS OF PEOPLE HAVE WALKED TO
KATHMANDU FROM AREAS OUTSIDE THE VALLEY TO TAKE
ADVANTAGE OF THE LOWER PRICES, WITH RESULT THAT RICE

CORPORATION WAS INCURRING LOSSES AT RATE WHICH WOULD AMOUNT TO NEARLY 20 MILLION RUPEES PER YEAR. THE PRICE IN KATHMANDU HAS NOW BEEN RAISED FROM RS 0.85 PER MANA TO RS. 1.15 PER MANA, EQUAL TO THE PRICE IN THE TERAI. THE GOVERNMENT ACTED AT THE SAME TIME TO INCREASE THE PRICE OF SUGAR FROM RS. 5.40 PER KG. TO RS 7.00 PER KG., EXPLAINING THAT THE INCREASE WAS NECESSARY BOTH TO SERVE AS AN INCENTIVE FOR FARMERS TO GROW SUGAR CANE, WHICH IS NOT NOW PRODUCED IN SUFFICIENT QUALITIES TO SUPPLY NEPAL'S REQUIREMENTS, AND TO PREVENT SMUGGLING OF SUGAR FROM NEPAL TO INDIA, WHERE THE PRICE IS HIGHER.

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3. COMMENT: THE GOVERNMENT'S ACTIONS HAVE LED TO A LIVELY EXCHANGE IN THE PRESS AND TO CRITICISM BY MOST NEPALIS WHO FEAR THE MEASURES WILL RESULT IN A NEW ROUND OF GENERAL PRICE INCREASES. INDEED, THE INCREASE IN PRICE OF COARSE PARBOILED RICE HAS ALREADY LED TO INCREASES IN PRICES OF OTHER VARIETIES OF RICE. WITH RICE THE STAPLE FOOD OF MOST INHABITANTS OF THE VALLEY, THE PINCH IS ALREADY BEING FELT. IN ADDITION TO CONCERN

OVER LIKELY INFLATIONARY IMPACT, THERE IS ALSO SKEPTICISM ABOUT THE WISDOM OF GOVERNMENT'S MEASURES. PRESS HAS POINTED OUT FOR EXAMPLE THAT IN CASE OF SUGAR CANE, PRICES WERE RAISED AFTER PLANTING SEASON WAS OVER, TOO LATE TO SERVE AS ANY INCENTIVE FOR FARMERS, WITH RESULT THAT SUGAR MILLS WILL REAP WINDFALL PROFITS. GOVERNMENT, HOWEVER, HAS SINCE ANNOUNCED THAT IT WILL APPROPRIATE OVER HALF OF PRICE INCREASE AS TAX WITH REMAINDER BEING DIVIDED BETWEEN FARMERS AND SUGAR MILLS. THERE HAS BEEN NO STATEMENT ON WHAT USE WILL BE MADE OF TAX PROCEEDS.

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4. IT COMES AS NO SURPRISE THAT INCREASE IN INTEREST RATES FOR LOANS HAS ELICITED WIDESPREAD OPPOSITION FROM PRIVATE SECTOR, WHICH ARGUES THAT MEASURES WILL RESULT IN GENERAL PRICE INCREASE AND WILL STIFLE INVESTMENT. MORE IMPORTANT, THERE ARE MANY WHO DOUBT THAT INCREASE IN INTEREST RATES FOR SAVINGS AND FIXED DEPOSITS WILL ATTRACT NEW FUNDS FOR SIMPLE REASON THAT CAPACITY TO SAVE IN NEPAL IS SEVERELY LIMITED AND ADDITIONAL FUNDS ARE THEREFORE NOT AVAILABLE. FINALLY, PRIVATE SECTOR POINTS OUT THAT PRESENT STRAIN ON BANKS' RESOURCES HAS BEEN CAUSED BY INCREASING DEMANDS FOR LOANS BY GOVERNMENT CORPORATIONS, WHICH ARE NOT REQUIRED TO POST COLLATERAL, AND WHICH OFTEN DO NOT UTILIZE FUNDS AFTER LOANS HAVE BEEN AUTHORIZED.

5. THERE IS NO QUESTION THAT OPERATIONS OF NEPAL'S FINANCIAL INSTITUTIONS MUST BE IMPROVED TO SERVE AS MORE EFFICIENT MOTOR FOR DEVELOPMENT. AN INCREASE IN INTEREST RATES BY ENCOURAGING MORE RIGOROUS ALLOCATION OF AVAILABLE RESOURCES CAN OFTEN SERVE THIS PURPOSE. WHILE IN SOME INSTANCES HIGHER INTEREST RATES MAY EVEN BENEFIT SMALL INVESTORS BY CURBING DEMAND OF LARGE BORROWERS THIS MAY NOT BE CASE IN NEPAL GIVEN FACT THAT GOVERNMENT AGENCIES THEMSELVES ARE LARGE SCALE BORROWERS. DISCUSSIONS WITH REPRESENTATIVES OF PRIVATE SECTOR INDICATES THAT THEY VIEW NEW GOVERNMENT MEASURES AS ANOTHER INSTANCE WHERE COMMUNICATIONS BETWEEN GOVERNMENT AND PRIVATE SECTOR HAVE BEEN LACKING AND AS RESULT THEIR INTERESTS HAVE NOT BEEN TAKEN INTO ACCOUNT. IT WOULD APPEAR THAT OTHER MEASURES, SUCH AS PROGRAMS TO MODERNIZE THE BANKING SECTOR, TO DEVELOP BETTER CLERICAL AND ENTREPRENEURIAL SKILLS IN NEPAL'S FINANCIAL INSTITUTIONS, AND ACTIONS TO ENSURE TIGHTER FISCAL MANAGEMENT BY GOVERNMENT CORPORATIONS AND GREATER INTERACTION BETWEEN THE PRIVATE AND PUBLIC SECTORS ARE ALSO PRIORITY NEEDS. THE

PRIVATE SECTOR WILL UNDOUBTEDLY FIND THE GOING TOUGH
IN THE FACE OF THE INCREASED INTEREST RATES AND IT IS
UNLIKELY THAT THE NEW MEASURES WILL GENERATE AS MUCH
PRODUCTIVE INVESTMENT OR INCREASED AVAILABILITIES OF
FUNDS AS THE GOVERNMENT HOPES. INDEED, IF THE MEASURES
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SET OFF A NEW ROUND OF PRICE INCREASES, THE INCENTIVE
MAY BE TO SPEND RATHER THAN SAVE.

6. IT IS POSSIBLE THAT IN ITS EAGERNESS TO PRESENT
AN AIR OF ACTION AND DECISIVENESS, THE NEW RIJAL
GOVERNMENT DID NOT FULLY CONSIDER ALL ITS OPTIONS
OR THE POLITICAL REPERCUSSIONS OF ITS RECENT MEASURES.
CERTAINLY IT HAS BROUGHT DOWN ON ITSELF A GREAT DEAL
OF CRITICISM. UNLESS THE MEASURES SUCCEED IN STIMULATING
AGRICULTURAL AND INDUSTRIAL PRODUCTION, THE OVERALL
EFFECT MAY BE TO WEAKEN THE POSITION OF THE PRIME
MINISTER AND THOSE AROUND HIM AND ENHANCE THE LIKELIHOOD
OF MINISTERIAL CHANGES LATER IN THE YEAR.
CARGO

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